

**Office of Chief Counsel
Internal Revenue Service
memorandum**

Number: **201405013**

Release Date: 1/31/2014

CC:PA:01

POSTN-140793-13

UILC: 6402.00-00, 6601.01-00

date: June 24, 2013

to: Associate Area Counsel (New York)
(Large Business & International)

from: Elizabeth Girafalco Chirich
Branch Chief, Branch 1
(Procedure & Administration)

subject: Applicability of Offset and Interest Provision Under Section 6601(f)

This Chief Counsel Advice responds to your request for additional assistance after we issued our advice relating to this taxpayer on another interest-related issue. This advice may not be used or cited as precedent.

LEGEND

Corporation 1 =
Corporation 2 =
Corporation 3 =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Date 6 =
Date 7 =
Date 8 =
Date 9 =
Date 10 =
Date 11 =
TY1 =
TY2 =
Amount 1 =

Amount 2 =
Amount 3 =
Amount 4 =

ISSUES

A domestic corporation underpaid its income taxes for TY1; its then-foreign parent overpaid its income taxes for TY1. On Date 1, the Internal Revenue Service refunded the foreign parent's overpayment. Over a year later, on Date 3 and Date 4, the foreign parent satisfied its former subsidiary's TY1 underpayment. Can the Service now offset this foreign parent's overpayment against the former domestic corporation's underpayment? If so, will section 6601(f) apply to eliminate the related interest liability on the domestic corporation's tax liability for TY1?

CONCLUSIONS

No. The Service cannot credit the foreign parent's overpayment against its former domestic subsidiary's underpayment because section 6402 is inapplicable. The tax liability belonged to the former domestic subsidiary, Corporation 1, and was not a liability "on the part of" the foreign parent, Corporation 2, the Corporation that made the overpayment.

Section 6601(f) only applies when the Service credits an overpayment against an underpayment under section 6402. So this issue is moot.

FACTS

Corporate Structure

Corporation 1 filed its TY1 corporate tax return as the parent of a consolidated group. In TY1, Corporation 1 was 100% owned by Corporation 2, a foreign parent. The corporations had separate and distinct EINs and were not members of the same consolidated group. On Date 5, Corporation 1 restructured, liquidated several subsidiaries, and converted to a State LLC that was also 100% owned by the same foreign parent, Corporation 2. As a result of this restructuring, Corporation 1 was treated, for federal tax purposes, as a disregarded entity. In determining the taxation of Corporation 1's change in classification for federal income taxes from a "C" corporation to a disregarded entity, Corporation 1 was deemed to have transferred its assets and liabilities to its foreign parent. Corporation 1 filed a final tax return and ceased to exist as a "C" corporation for federal income tax purposes even though Corporation 1 continued in existence as an LLC under State law.¹ On Date 6, under State law, the LLC (previously Corporation 1) dissolved. In so doing, the LLC transferred all of its assets and liabilities to Corporation 2, its foreign parent, pursuant to an asset and liability transfer agreement. The foreign parent consented to the transfer and legally

¹ See I.R.C. § 332.

assumed full responsibility for all of the LLC's liabilities. Subsequently, the foreign parent changed its name to Corporation 3.

Deficiency and Overpayment

The Internal Revenue Service audited the TY2 income-tax returns of Corporation 1 and its then-foreign parent, Corporation 2. As a result of the audit, the Service made a section 482 adjustment that allocated a TY2 bad-debt deduction from Corporation 1 to Corporation 2, the foreign parent. The section 482 adjustment increased the foreign parent's TY2 net operating loss (NOL), which the foreign parent carried back to its TY1, resulting in an overpayment of its TY1 taxes. Conversely, the adjustments with regard to TY2 resulted in a reduced net operating loss for Corporation 1 for TY2, which ultimately resulted in a reduced net operating loss carryback to TY1. Therefore, Corporation 1 ended up with a deficiency for TY1 of Amount 2, which the Service assessed on Date 2. On Date 1, the Service refunded the foreign parent's overpayment, in the amount of Amount 1, including interest. On Date 3 and on Date 4, Corporation 3 paid Corporation 1's TY1 liability in the respective amounts of Amount 3 and Amount 4, which completely satisfied Corporation 1's TY1 tax liability, including interest.

Claim for Refund and Request for Abatement

On Date 7, Corporation 1 filed a Form 843, seeking a refund of the underpayment interest that had accrued on its TY1 underpayment based on the provisions of section 6601(f). The Service denied the claim on Date 8.² In the Service's denial letter, it provided that it was "no longer able to apply section 6601(f)" because "the overpayment has been refunded." Further, the Service explained that it did not apply Corporation 2's overpayment against Corporation 1's underpayment because "the overpayment and the liability involved two different entities" and "no evidence was provided that Corporation 2 requested their overpayment be applied to Corporation 1 liability." On Date 11, Corporation 3, as successor to Corporation 1, filed a Form 843, again seeking a refund of the underpayment interest that had accrued on Corporation 1's TY1 underpayment. Corporation 3 argued that the Service did not follow Internal Revenue Manual Procedures established to offset refunds and tax liabilities that are generated by section 482 primary and correlative adjustments, and, therefore, it was entitled to a refund of the interest paid on Corporation 1's underpayment. (The claim also appears to request interest abatement under section 6404(e), but we have not been asked to opine on that issue.) The Service has not yet acted on this claim.

Our advice is based on the information that the taxpayers provided in their three claims as well as the additional background materials that you submitted.

LAW AND ANALYSIS

² On Date 9, Corporation 1 filed a claim for interest netting, seeking a refund of a portion of the underpayment interest that had accrued on its TY1 underpayment. The Service denied the taxpayer's claim on Date 10.

In lieu of refunding an overpayment of tax to a taxpayer, the Service “may” credit the overpayment against an outstanding underpayment “on the part of the person who made the overpayment.” I.R.C. 6402(a). Thus, whenever the Service determines an overpayment of tax, and another tax liability of the person who made that overpayment remains unpaid, the Service has the discretion, under section 6402(a), of refunding that overpayment or crediting it against the outstanding underpayment. *Northern States Power Co. v. United States*, 73 F.3d 764, 767 (8th Cir 1996); *Pettibone Corp. v. United States*, 34 F.3d 536, 538 (7th Cir. 1994). See also Treas. Reg. § 301.6402-1. When such an overpayment is credited against an underpayment, and the taxpayer owes underpayment interest on the portion of the underpayment so satisfied by that overpayment, section 6601(f) eliminates that underpayment interest for the overlapping period during which interest would have been allowable to the taxpayer on the overpayment had the Service not credited the overpayment to the underpayment. I.R.C. § 6601(f). While section 6601(f) eliminates underpayment interest, this provision *only* applies if the Service first credits an overpayment against an underpayment pursuant to section 6402(a). See *Northern States Power*, 73 F.3d at 768. In other words, if a section 6402(a) credit is not made, interest continues to accrue independently during an overlapping period on both the overpayments and underpayments. So interest on an overpayment that is refunded would run from the date the overpayment arises until a date preceding (but no more than 30 days preceding) the date when a refund check is sent. I.R.C. § 6611(b)(2). And interest accrues on the tax underpayment from the prescribed payment date until the date on which the tax is paid. I.R.C. § 6601(a).

Section 6402 is inapplicable in this case, though, because the tax liability belonged to Corporation 1 and was not a liability “on the part of” Corporation 2, the Corporation that made the overpayment.³ I.R.C. § 6402(a). Accordingly, the taxpayer’s 6402 argument is without merit. And, as discussed, section 6601(f), which imposes no underpayment interest on any portion of tax satisfied by credit of an overpayment, applies only when the Service credits an overpayment under section 6402(a). The overpayment in issue here was not credited under section 6402(a). Therefore, section 6601(f) is inapplicable in this case to eliminate the underpayment interest that accrued on Corporation 1’s TY1 underpayment.

You also asked us to address the taxpayer’s argument that it is entitled to a refund of interest paid on its TY1 underpayment because the Service did not follow IRM procedures that provide that correlative taxpayers “must be given the opportunity of applying any overassessment against the deficiencies of the primary taxpayer....” IRM 4.10.13.5.2.2. Although the Service has such procedures in place, it does not follow that the Service acted inappropriately if it did not follow these procedures. See

³ We do not address here whether it can be argued that, because the foreign parent, Corporation 2, consented to the transfer and legally assumed full responsibility for all of Corporation 1’s liabilities, the tax liability is “on the part of a person who made the overpayment.” In any event, section 6402 is discretionary, and the Service did not -- and was not required to -- offset under section 6402.

Vallone v. Commissioner, 88 T.C. 794, 807-08 (1987) (IRM requirements are necessarily merely directory and not mandatory, and if the Service does not follow these procedures, that does not render the Service's action invalid). *See also United States v. Horne*, 714 F.2d 206, 207 (1st Cir. 1983). Further, courts have generally said that the IRM is "not for the protection of taxpayers." *Vallone*, 88 T.C. at 808. Moreover, we suspect that the objective of the referenced IRM procedures (directing revenue agents to offer correlative taxpayers the opportunity to apply resulting overpayments against resulting deficiencies) is not to address interest-rate discrepancies that may arise following a 482 adjustment, but rather to safeguard the fisc. Collecting the deficiency immediately by applying the overpayment -- rather than refunding the overpayment and having to collect the deficiency later -- ensures all or part of the deficiency will be paid.

This writing may contain privileged information. Any unauthorized disclosure of this writing may undermine our ability to protect the privileged information. If disclosure is determined to be necessary, please contact this office for our views.

Please call (202) 622-4910 if you have any further questions.